Internal Revenue Service

memorandum

CC:TL-N-100-90
VWATERS

date: NOV 7 1989

to: District Counsel, [redacted]
Attn: [redacted]

from: Assistant Chief Counsel (Tax Litigation)

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subject [redacted] - TEFRA Partnership Assessment

This memorandum is in response to your request of October 2, 1989, regarding the above-mentioned subject. Specifically, you have asked that we respond to questions raised by the [redacted] Examination Division in a memorandum dated September 15, 1989.

ISSUES

1. Whether a Form 872-O executed by [redacted] as tax matters partner ("TMP") of [redacted] is binding on the consolidated return group?

2. Whether a Form 870-P executed by a subsidiary partner ([redacted]) agreeing to a deficiency for the parent corporation ([redacted]) is valid even though the subsidiary partner was no longer owned by the parent corporation?

3. Whether the Form 872-O is still effective in light of the execution of the Form 870-P?

4. If the Form 870-P is invalid, should the Service abate an improperly made assessment based on the Form 870-P in such case?

CONCLUSIONS

1. The Form 872-O executed by [redacted] as TMP of [redacted] is binding on the consolidated return group. The Form 872-O is binding on all members of the [redacted] group who are parties within the meaning of section 6231(a)(2)(B).

2. We believe that the Form 870-P would not be binding on the members of the consolidated return group. As such, we recommend that such consent be executed by the common parent. The consent should indicate that the common parent is executing the consent on behalf of the consolidated return group.

3. In general, where a partner enters into a settlement agreement with the Service, his partnership items are converted to nonpartnership items, and the Service has one year to assess the deficiency attributable to the settlement agreement. However, because the Form 870-P did not operate to convert the partnership items to nonpartnership items, the Form 872-O continues to be binding on all members of the consolidated return group with one exception. If the district director notified the common parent that the Service would deal directly with the subsidiary, the Form 870-P would be binding on the subsidiary. As such, the Service would have one year to assess the deficiency. Because the facts are unclear as to whether such notice was given, there are hazards that the Service would be precluded from assessing the deficiency against the subsidiary after one year from the date on which the Form 870-P was executed. Therefore, we recommend that the Service assess the deficiency against the subsidiary before the one year period of limitations expires.

4. The Service should abate the assessment since it was based on the invalid Form 870-P.

FACTS

The [redacted] was examined for the taxable years [redacted], [redacted] and [redacted] resulting in reduced partnership losses in [redacted] and [redacted] and an increased loss in [redacted]. A Form 872-O was executed by [redacted]'s tax matters partner ("TMP") for the [redacted] and [redacted] taxable years. The results of the examination were agreed to at the appellate level by the execution of Form 870-P's. The Form 870-P's were executed by [redacted], [redacted] and [redacted] (executed by [redacted] as TMP). The Service signed and accepted the Form 870-P's on November 15, 1988.

[redacted] consisted of [redacted]% partners, [redacted] and [redacted]. [redacted] Terminals was in turn owned [redacted]% by [redacted], a [redacted]% owned subsidiary of [redacted], a [redacted] based [redacted] taxpayer. [redacted] filed as part of the [redacted] consolidated return group for the taxable years [redacted] and [redacted] but was spun off by [redacted] on [redacted]. [redacted] filed a short year (ending [redacted]) consolidated return with [redacted] in [redacted] and the [redacted] consolidated return group claimed the entire [redacted] partnership loss of $[redacted] despite the fact the [redacted] was no longer the owner of [redacted] on [redacted].

[redacted] is currently under examination for these same taxable years (with its own statute extension). The examination is not scheduled to be completed until substantially after the expiration of the partnership assessment statute. The tax computation which would be required to reflect any partnership income adjustment on an interim basis is prohibitive, especially in light of the number of partnerships [redacted] is associated with and the potential for separate examinations.

On July 12, 1989, the Kansas City Service Center issued a Form 4549-A to [redacted] indicating the dollar amounts of the partnership adjustments and a tax deficiency/overassessment. These amounts have been assessed.

DISCUSSION

I. Whether the Form 872-O is Binding on the Consolidated Return Group

The Form 872-O executed by [redacted], [redacted]'s TMP, is binding on the [redacted] consolidated return group even though [redacted] was not a member of the consolidated return group. In general, if any member of a consolidated return group is a partner in a partnership under section 6231(a)(2)(A), all other members of the group will be considered to be "partners" pursuant to section 6231(a)(2)(B). Section 6231(a)(2) provides:

> Partner.- The term "partner" means-
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> (A) a partner in the partnership, and
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> (B) any other person whose income tax liability under subtitle A is determined in whole or in part by taking into account directly or indirectly partnership items of the partnership.

Since the common parent ([redacted]) of the consolidated return group files a return covering all members of the group, every member of the group will have its tax liability determined in part by taking into account partnership items of the subsidiary partner. Treas. Reg. § 1.1502-6 provides that each corporate member of a consolidated return group is severally liable for the consolidated tax liability of the group. Hence, each corporate member is liable for any additional tax liability resulting from the partnership income items of a subsidiary partner. Since every member of the consolidated return group has its tax liability determined by taking into account partnership items, they are partners pursuant to section 6231(a)(2)(B).

Section 6229(b)(1)(B) empowers the TMP to extend the period of limitations for all "partners". The rationale for concluding that an extension by the TMP binds all group members is that the consolidated return agency provisions of Treas. Reg. § 1.1502-77 only provides that the common parent is the agent for acting on behalf of the other group members in respect to actions that the group members could have taken themselves absent the agency capacity of the common parent. A non-TMP partner is bound by an extension executed by the TMP pursuant to section 6229(b)(1)(B) and has no capacity to avoid the statutory extension. Therefore, because the subsidiary partner has no authority to avoid the statutory extension, its deemed agent, the common parent (which is also a partner under section 6231(a)(2)(B)), also has no authority to avoid the extension.

II. Whether a Form 870-P signed by a Subsidiary Partner is Binding on the [redacted]

Section 6224(c)(1) provides:

> A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. An indirect partner is bound by any such agreement entered into by the pass-thru partner unless the indirect partner has been identified as provided in section 6223(c)(3).

Section 1.1502-77 provides:

> The common parent, for all purposes [other than certain listed exceptions not here relevant] shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. . . . no subsidiary shall have authority to act for or to represent itself in any such matter. . . . The common parent. . . in its name will give waivers, give bonds, will execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise or any other document so executed, shall be considered as having also been given or executed by each such subsidiary. . . .Notwithstanding the provisions of this paragraph, the district director may, upon notifying the common parent, deal directly with any member of the group in

respect of liability, in which event such member shall have full authority to act for itself.[1]

One of the questions presented in your request was whether a Form 870-P executed by the subsidiary partner ([redacted]) is binding on the [redacted] consolidated return group. A Form 870-P is a form on which partnership adjustments are settled and restrictions on assessments are waived. Since a settlement of a partnership adjustment and an agreement to waive assessment of tax attributable to such an adjustment relate to the tax liability of the consolidated return group, the above regulation mandates that only the common parent may execute such agreements on behalf of the consolidated return group. Only this type of execution would unquestionably be binding with respect to the consolidated return group, all subsidiaries and the parent. Consequently, the Form 870-P executed by the subsidiary was not binding on the consolidated return group.

The facts in this case indicate that at the time the subsidiary signed the Form 870-P it was no longer owned by the common parent. However, the aforementioned conclusions apply regardless of whether the subsidiary was no longer a member of the consolidated return group at the time the Form 870-P was executed. In either case, the common parent is still the proper party to execute the Form 870-P.

Accordingly, there is a substantial hazard that a settlement by the subsidiary will be invalid, given the mandate of section 1.1502-77 that a parent is the "sole agent" of the subsidiary in tax matters for the consolidated return year. As such, we recommend that a Form 870-P be executed by the common parent. The consent should indicate that the common parent is executing the consent on behalf of the consolidated return group.[2]

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[1] There is no indication that the district director notified the common parent that the Service planned to deal directly with the subsidiary. Therefore, the conclusions reached in this memorandum are based on the assumption that no notice was provided. It should be noted, however, that if notice was provided, the Form 870-P executed by the subsidiary would be binding on the subsidiary. As such, the Service would be required to assess the deficiency against the subsidiary prior to [redacted].

[2] The Form 870-P executed by [redacted] is valid since it is not a member of the consolidated return group. As such, the partnership items converted to nonpartnership items and the Service has one year from the date on which the agreement was signed on behalf of the Commissioner to make an assessment

III. Whether the Form 872-O is Still Effective

Under section 6229(a), the period for assessing any tax attributable to partnership items or affected items with respect to any partner will not expire before three years from the later of the due date of the partnership return (determined without regard to extensions) or the date the partnership's return is filed. A Form 872-O may be executed to extend the period of limitations at the partnership level. A Form 872-O provides for an open-ended statute extension. As noted above, [redacted] Terminals as TMP of [redacted] executed a Form 872-O. The Form 872-O continues to be binding on the consolidated return group since the Form 870-P executed by [redacted] was ineffective to settle the partnership items on behalf of the consolidated return group.

In general, if the Service enters into a written settlement agreement with any partner, his partnership items are converted to nonpartnership items as of the date the Service and the partner enter into an agreement with respect to such items. I.R.C. § 6231(b)(1)(C). Upon conversion, the Service must assess the deficiency attributable to the settlement agreement within one year from the date on which the agreement was executed by the Service. See I.R.C. § 6229(f). In addition, the Form 872-O would no longer apply to the nonpartnership items since it only operates to extend the period of limitations for assessment with respect to partnership items.

In this case, the Form 870-P executed by the subsidiary was not binding on the consolidated return group. Therefore, the Form 870-P did not operate to convert the partnership items to nonpartnership items, and the Form 872-O continues to be binding on all members of the consolidated return group.

It should be noted that if the district director notified the common parent that the Service planned to deal directly with the subsidiary, the Form 870-P would be valid and binding as to

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pursuant to section 6229(f). Therefore, the assessment must be made by [redacted].

It should be noted that the Technical and Miscellaneous Act of 1988 ("TAMRA") provided an amendment to section 6229(f) to allow for extensions of the one year statutory period for making assessments. The Service has created a new form, Form 872-F, which must be executed to extend section 6229(f). However, the delegation order on the Commissioner's side approving this form has not yet been issued.

the subsidiary. The Form 872-O would not operate to extend the period of limitations with respect to the subsidiary's settled partnership items. The Service would be required to assess the deficiency against the subsidiary prior to [redacted], the date on which the Form 870-P was executed. If it cannot be timely determined whether the district director did in fact provide notice to the common parent, we recommend that the Service assess [redacted] prior to [redacted], to protect against expiration of the one year period of limitations. If, however, it is subsequently determined that the district director did not provide such notice, the assessment should be abated for the portion of the assessment relevant to the short year consolidated return.

IV. Abatement of the Improperly Made Assessment

The facts in this case indicate that the Service made an assessment against [redacted] based on a deficiency attributable to the Form 870-P. As noted above, the Form 870-P executed by the subsidiary was not effective to settle the partnership items of the consolidated return group and specifically [redacted], the common parent. The Service, therefore, erroneously assessed the deficiency against [redacted] attributable to the Form 870-P. Where the Service erroneously makes an assessment, the Code authorizes the Service to abate the unpaid portion of the assessment. See I.R.C. § 6404(a)(3). Consequently, in light of the erroneous assessment, we recommend that the Service abate the assessment pursuant to section 6404(a)(3).

In addition, we recommend that the Service abate the deficiency assessed against [redacted] even if it is subsequently determined that the district director notified the common parent that it planned to deal directly with the subsidiary. The rationale underlying this conclusion is that the subsidiary would only have authority to act for itself in matters relating to tax liability and has no authority to bind the consolidated return group to a settlement agreement.

If you have any additional questions regarding this matter, please contact Vada Waters at (FTS) 566-3289.

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